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October 28, 2002

Via hand delivery

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D. C. 20554

Re: WCB Docket No. 01-338

Dear Ms. Dortch:

On October 28,2002, Praveen Goyal and Jason Oxman of Covad Communications met with Elizabeth Yockus, Julie Veach, and Jeremy Miller, all of the Wireline Competition Bureau, to discuss the Triennial Review proceeding. Covad's points are summarized in the attached presentation

Respectfully submitted,

Florence Grasso

Florence Grasso

Cc: Elizabeth Yockus
Julie Veach
Jeremy Miller

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Remote Terminal Access/Broadband UNE

Jason Oxman

Praveen Goyal

October 28, 2002

Outline

- Recognizing impairment for fiber-fed loops
- Protecting investment incentives
- Roadmap to a Broadband UNE

Covad is fulfilling the broadband promise

- Covad's nationwide network reaches 45% of the nation's homes and businesses -- the largest national broadband network. Booking over a thousand new orders *each day.*
- True wholesaler to the nation's largest residential ISPs
  - Wholesale ISPs: AOL, Earthlink, AT&T, dozens of others.
- True wholesaler to small business carriers. The only nationwide business-class DSL provider -- no ILEC offers it.
  - Wholesale carrier customers: Sprint, SBC, AT&T, WorldCom.
- Current customer base is 50% residential (100% new customers are linesharing) and 50% small business.
- The only force leading broadband prices *down*

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Need for UNE Access to Fiber-Fed Loops

- A bottleneck is a bottleneck – does not matter whether the loop is made of copper or glass. The Commission's loop analysis applies equally to all copper loops and copper/fiber loops.

- Today, hybrid fiber-copper loops account for approximately 21% of nationwide loop plant. (Covad Initial Joint Decl. ¶ 33 n. 14)

- The ILECs prevent Covad from providing service to more than one-fifths of all end users. In 2001, Covad was forced to turn away over 24,000 customers because of ILEC refusal to provide access (Covad Initial Comments at p. 58).

- Data transmission, including NGDLC technology, is the future of the public switched network – without FCC action in *Triennial Review,* Covad will gradually become locked out of providing competitive alternatives to consumers

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Rapid Pace of ILEC Fiber Deployment

- BellSouth: broadband deployment in more than 8,700 RTs – more than any other ILEC (BellSouth 2001 10-K report)
  "Over 90% of our customers are within 12,000 feet of fiber optic cables."

- SBC finished 2001 with over 5000 RTs in service, up from 2000 at the beginning of 2001. (SBC 4Q 2001 IO-Q report)
  By the end of 2001, SBC's **DSL** network reached 25 million customer locations, up 37% from the year before.

- By the end of 2001, Verizon had deployed **DSL** to 79% of its access lines. (Verizon 4Q 2001 IO-Q report)
  Ivan Seidenberg, Verizon's CEO: "Our view is we can get speeds up to 1.5 Mbs over the next year or 2 and then beyond that speeds of 6 megabit range... Eventually the access network becomes a broadband and database-centric network." (p. 10, Comm Daily, Oct. 23, 2002).

- If the Commission does not act now, competitors will become progressively locked out from serving an increasingly greater share of the broadband market

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Inability to Duplicate ILEC Loop Plant

- CLEC and ILEC costs to construct fiber feeder and NGDLC plant are not even close to being the same
- ILECs enjoy impossible-to-duplicate advantages in their loop plant
- Network infrastructure, including fiber-deployment, developed under rate-of-return cost recovery from captive ratepayers
- ILEC advantages include extensive rights-of-way, poles, ducts, conduits, existing copper plant, existing remote terminals, existing central offices, and unique economies of scale in labor and facilities costs

RT Collocation Is Not a Viable Alternative

- Remote terminal collocation is not a viable substitute for broadband UNE – even Qwest admits cost to collocate is approximately $90,000 per RT (Covad Joint Initial Decl. at 17)
- Bell companies have traditionally fought RT collocation as intrusive and unnecessary -- SBC and Verizon have proposed broadband service as a replacement for RT collocation.
- Remote terminal collocation carries much higher aggregate costs than a broadband UNE. Inefficiencies include: space preparation (assuming space even available), independent power source for DSLAM, cross-connects between stand-alone DSLAM and fiber and copper appearances in RT (including technician dispatch costs), and additional maintenance costs (from additional points of failure).
- Remote terminals have much smaller scale economies than central offices. (remote DSLAM deployment, –300 end users per RT; Lightspan deployment, –1200 end users per RT). (See Covad Joint Initial Decl. at 17-18)
- Broadband users constitute a fraction of that (conservatively, –11% take rate). CLEC broadband entrants constitute a further fraction of that (Covad Joint Initial Decl. at 18). Estimated 14.2 years to recoup costs of collocation alone – long after the economic life of the collocated equipment itself is over. (Covad Joint Initial Decl. at 18).

Myth #1: ILECs can't compete with cable under current regulatory regime.

Facts:

- ILECs are competing and gaining DSL subscribers at a greater rate than cable is gaining subscribers.
- Under existing regulatory regime, SBC DSL has more DSL subscribers that 7 out of the 9 largest cable modem providers. *(See Wachovia Securities Report, Aug. 9 '02)*
- SBC's DSL growth rate is so high that in Q3 '02 its subscriber count surpassed AT&T Broadband (#2 cable provider). *(See Wachovia Securities Report, Oct. 25 '02)*
- BellSouth added 121,000 new DSL subs in the 3q 2002, compared with 74,000 new adds in 2q 2002
- SBC added 226,000 in 3q2002, versus 213,000 in 2q2002, best results in the last 7 quarters.
- Verizon added155,000 new net DSL subs, a 70 percent increase year-over-year, for a total of 1.64 million lines

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Myth #2: If ILECs are forced to unbundle their "new" network, they will not invest.

- SBC is investing in Project Pronto throughout its footprint, notwithstanding current state of the law.
- In its 2000 annual report, SBC stated to investors that DSL unbundling obligations had no material impact on its operations or financials - this report was released after it was ordered to unbundle Project Pronto in Illinois.
- ILEC's need to invest in DSL architecture to offset losses on voice and reduce churn in the voice market.
  - Loss of voice customers proves that competition is working and consumers are reaping the benefits.
- SBC tells Wall Street that its DSL investment is profitable *(See Banc Of Ameritech Securities Report, Sept. 20 '02)*
- SBC has told investors that its 2002 CAPEX figures support growth areas such as data. *(See Banc Of Ameritech Securities Report)*

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Investment Incentives and TELRIC

- Supreme Court soundly approved Commission's TELRIC scheme for UNE pricing: "[A] regulatory scheme that can boast such substantial competitive capital spending over a 4-year period is not easily described as an unreasonable way to promote competitive investment in facilities." *Verizon v. FCC*, 122 S.Ct. 1646, 1676.
- Apart from vague rhetoric, no concrete showing by the RBOCs that unbundling at TELRIC rates actually undermines broadband network investment
- Willig study points to opposite conclusion. In fact, unbundling at TELRIC rates stimulates efficient aggregate investment in network facilities.
- Contrary to RBOC rhetoric, non-UNE facilities are the ILECs' worst nightmare (witness wireless substitution for voice). Unlike non-UNE competition, UNEs protect ILEC sunk costs for fixed capital expenditures through wholesale revenue at cost, plus a reasonable profit.
- *Did somebody say ulterior motive?* Maybe the ILECs know that no one can duplicate their ubiquitous network plant.

The Truth about DLC Investment

- Fiber feeder deployment saves the ILECs money. Fiber feeder pays for itself through the reduction in costs for maintaining legacy copper network facilities. Operating expenses for fiber feeder are cheaper than copper feeder plant.

- Numerous state commissions have found this to be true, determining that a hybrid fiber-copper network is the most efficient network design in TELRIC rate-setting proceedings.

- *Not just theory, but business fact*. Prior to Triennial Review, RBOCs openly touted the efficiencies gained from NGDLC deployment. "The network efficiency improvements alone will pay for this initiative...

  "[T]he efficiencies SBC expects to gain will pay for the cost of the deployment on an NPV basis. These efficiencies are conservatively targeted to yield annual savings of about $1.5 billion by 2004 ($850 million in cash operating expense and $600 million in capital expenditures)." *SBC Announces Sweeping Broadband Initiative*, SBC Investor Briefing, at 2 (October 18, 1999).

Protecting Incentives to Invest

- UNE pricing consists of (1) the TELRIC of a network element, which has three components: operating expenses, depreciation costs, and risk-adjusted capital costs (Local Competition Order ¶ 703); along with (2) recovery of a reasonable profit. *See* 47 USC § 252(d)(1).
- The Supreme Court has recognized the broad authority of state commissions to consider adjustments to depreciation and capital costs to account for particularly risky investments. *Verizon v. FCC*, 122 S.Ct. at 1677-78.
- "TELRIC rates leave plenty of room for differences in the appropriate depreciation rates and risk-adjusted capital costs depending on the nature and technology of the specific element to be priced." *Verizon v. FCC*, 122 S.Ct. at 1678.
- Indeed, the BOCs themselves have promoted shortening depreciation schedules and raising cost of capital factors as the means to protect their incentives to engage in risky investments. *See, e.g.,* William Barr 7/16/02 letter and William Daley 9/4/02 letter to Chairman Powell.

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Roadmap to a Broadband UNE

- ***Clarify existence of obligation.*** Commission's existing UNE loops rules need to be clarified.
- ***Guidance for state PUC implementation.*** Triennial Review Order should include examples of broadband loop features and functions that ILECs must make available to CLECs.
- ***Investment incentives.*** Post-*Verizon* v. *FCC,* Commission should refrain from any alteration of the TELRIC rules. Commission can, however, clarify manner in which state commissions can apply TELRIC, including depreciation and cost of capital factors, to set UNE rates that ensure adequate cost recovery in risky environment, if any such additional costs are proven by the BOC to the state commission in a cost proceeding.
- ***Response to USTA v. FCC?*** Current record is more than sufficient to establish impairment for UNE loops, including fiber-fed loops. Loop facilities between CO and end user epitomize impairment.
- ***Loops are core bottleneck facilities.*** No question that last-mile UNE loop facilities must remain on list of UNEs.

Commission's Existing Rules Apply

- Loop UNE "includes all features, functions, and capabilities" of the loop, including "attached electronics" (47 C.F.R. § 51.319(a)(1))

- Commission's packet-switching definition was meant to apply to stand-alone packet-switching equipment, not to loop facilities (47 C.F.R. § 51.319(c)). Commission's failure to clarify parameters of packet-switch exemption have caused 3+ years of litigation.

- The Commission should delete the packet switching rules in 47 C.F.R. § 51.319(c)(5), and clarify its UNE loop rules in § 51.319(a)(1):

> Local loop. The local loop network element is defined as a circuit- or packet-switched transmission facility between a distribution frame, optical concentration device, or equivalent device in an incumbent LEC central office and the loop demarcation oint at an end- user customer premises, including inside wire owned by the incumbent LE C. The local loop network element includes all features, functions, and capabilities of such transmission facility. Those features, functions, and capabilities include, but are not limited to, dark fiber, attached electronics (including the ability to alter the quality of service settings thereof), and line conditioning. The local loop includes, but is not limited to, DS1, US3, fiber, and other high capacity loops.

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FCC Guidance for State Implementation

- In current DSL marketplace, CLEC service differentiation has been crucial to expansion of broadband market (e.g., Covad SDSL and low-priced ADSL offerings). Broadband UNE loops should allow for similar service differentiation.

- TELRIC fully compensates costs of OSS implementation and ATM/PVC engineering for broadband UNE loops

- ILEC retail offerings over broadband loops should be a floor, not a ceiling, for what is technically feasible to unbundle.

- Same rule framework should apply to both remote DSLAM and NGDLC architectures

FCC Guidance for State Implementation

- FCC should require access to technically feasible configurations of broadband UNE loops, including but not limited to:
  - Technically feasible PVC types (UBR, CBR, VBR-nrt and VBR-rt)
  - Technically feasible PVC bandwidths (limited by technical capabilities of RT line card and physical limitations of subloop components)
  - Both symmetric and asymmetric PVC configurations
  - UNE loop offerings must include loop offerings with capabilities to offer voice and data PVCs on one loop.
  - FCC should require ILEC to provide option of any technically feasible virtual line card collocation at the RT, subject to ILEC demonstration of technical infeasibility of a particular configuration to state PUC.
  - Presumption of technical feasibility for commercially available line card and RT configurations
  - Technically feasible troubleshooting and alarm monitoring features for ATM PVCs (e.g., remote terminal loopback, PVC status messaging, port status messaging).

Impairment Analysis

- 251(d)(2) impairment
  - no alternative to the BOC loop plant
  - Fiber-fed loop analysis the same as copper loops – the physical medium of the loop is irrelevant to whether competitors are impaired
  - Record is clearly sufficient for Commission to make impairment finding. Sufficient evidence on lost potential market share, incumbent advantages, costs to duplicate network, and cost to collocate at RTs.
- 251(d)(2) "at a minimum" --- policy questions
  - USTA v. *FCC* faults commission for failing to consider overall competition for line sharing unbundling only
  - Facilities-based competition requires unbundled access to BOC transmission grid, including fiber-fed loops, or there is no way to reach the end user.
  - Monopoly in broadband (or, at best, duopoly) harms consumers.

Loops are the core of section 251(c)(3)

- UNE loop facilities epitomize impairment - no question that last mile UNE loop facilities must continue to be unbundled
- *USTA v. FCC* decision requiring analysis of cable modem competition disturbed only the Commission's *Line Sharing Order*
- An "exit strategy" is exceedingly out-of-place for UNE last mile facilities like the loop.
- Only wholesale availability of alternative, equivalent last mile facilities in unconcentrated markets for specific EO-end user routes would provide sufficient basis for removal of unbundling requirements for a specific ILEC loop facility.
- Covad's impairment test for ILEC transmission facilities based on HHI analysis creates such a framework.
- However, exceedingly impractical and administratively burdensome to apply route-specific impairment analysis to UNE loop facilities.

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